

# SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Wyman Analyst: Darrine Distefano Bill Number: AB 1862

Related Bills: See Prior Analysis Telephone: 845-6458 Amended Date: 05-06-2002

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Credit for Employee Benefits Paid to Employees Who Are On Active Duty With National Guard or Military Reserve On or After 9/11/2001

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

X AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced January 31, 2002.

X FURTHER AMENDMENTS NECESSARY.

X DEPARTMENT POSITION CHANGED TO Neutral if amended.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED January 31, 2002 STILL APPLIES.

X OTHER - See comments below.

## SUMMARY

This bill would allow a credit for wages paid to a qualified employee who is on active duty as a result of Operation Enduring Freedom or any successor military action, including homeland defense.

## SUMMARY OF AMENDMENT

The May 6, 2002, amendments made the following changes to this credit:

- Added a sunset date of January 1, 2010.
- Revised the credit amount from 100% to an amount equal to the benefits paid to an employee during the taxable year. This amount may not exceed a currently unspecified cap.
- Added a definition of active duty or service for a qualified employee.
- Added homeland defense as an example of a successor military action for which a qualified employee can be called to active duty or service to perform.
- Added language that an employer may not take a deduction for the amount of the credit taken.
- Added tax levy language.

The May 6th amendments also deleted the Government Code and Military and Veterans Code provisions regarding employees ordered to active duty as a result of Operation Enduring Freedom.

Board Position:

<u>      </u> S	<u>  X  </u> NA	<u>      </u> NP
<u>      </u> SA	<u>      </u> O	<u>      </u> NAR
<u>      </u> N	<u>      </u> OUA	<u>      </u> PENDING

Legislative Director

Date

Brian Putler

5/14/02

The amendments did not resolve the implementation considerations raised in the department's analysis of the bill dated January 31, 2002. However, the amendments did resolve two of the policy concerns. In addition, the amendments raise two new technical concerns. The remaining implementation considerations and policy concerns are repeated below for convenience.

## **EFFECTIVE/OPERATIVE DATE**

This bill is a tax levy. It would be effective immediately, and apply to taxable years beginning on or after January 1, 2002, and before January 1, 2010.

## **POSITION**

Neutral, if amended.

On March 25, 2002, the Franchise Tax Board voted 2-0 to be neutral on this bill if it is amended to resolve the policy and implementation concerns addressed in the analysis of the bill as introduced.

## **Summary of Suggested Amendments**

Amendment 1 has been provided to correct a technical consideration.

## **IMPLEMENTATION CONSIDERATIONS**

This bill does not limit the number of years the credit may be carried over to future years. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a limitation on the number of years for carryovers since experience shows credits typically are exhausted within eight years of being earned.

The author may wish to further define military pay and allowances. Certain benefits are excluded from gross income but appear on the employee's military paycheck. It may be difficult for employers to know what these items are in order to determine how much should be paid to make up the difference. In addition, an employer may provide health, dental, retirement, or cafeteria plan payments for their employee. It is not clear if the employer would have to consider these types of payments to calculate the differences in pay. While it appears the bill's intent is to make up the difference in salary regardless of what items are taxable, further clarification will be helpful for the employer and the department in administering this bill.

## **TECHNICAL CONSIDERATIONS**

The word "active" is repeated twice in one place. An amendment is provided to eliminate the redundancy.

The bill identifies "homeland defense" as a successor to Operation Enduring Freedom. Amendments 2 & 3 are provided to ensure that benefits paid by employers to all employees called up for homeland defense are eligible for the credit.

## **ECONOMIC IMPACT**

### Revenue Estimate

Based on the discussion below, this bill would result in the following revenue losses as shown in the following table:

Revenue Impact of AB1862 As Amended 05-06-2002 For Taxable Years Beginning On Or After 1/1/2002 Fiscal Year Impact (In Millions)		
2002-3	2003-4	2004-5
-\$60	-\$30	-\$10

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

### Revenue Discussion

The impact of this bill would depend upon; (1) the number of employers incurring qualifying expenses for benefits paid to employees who are on active duty during the taxable year and (2) the average credit applied against tax liabilities.

The above estimates reflect those for the original version, reduced by \$1 million annually to allow for the \$75,000 credit cap under this bill. In addition, the revised estimates include a \$5 million annual revenue loss attributed to Homeland Security military personnel in California (500 personnel times an average employer credit of \$10,000).

This estimate assumes that the author's intent was that a "qualified employee" be a resident of California.

Based on the actual number of reservists and National Guard called to active duty to date in California for Operation Enduring Freedom, it is estimated that approximately 6,500 personnel years of reservists and National Guard would be on active duty in 2002. For 2003 it was assumed that one fourth as many would be called for active duty, and for 2004 and thereafter it was assumed that a minimal number of reservist and National Guard would be called as a result of Operation Enduring Freedom or any successor military action.

According to information from various sources, it is estimated that the number of reservist and National Guard called to active duty would decline significantly over time for the above military action. If, however, additional personnel are called to active duty in 2002 or thereafter, the revenue impact could be much greater.

## **ARGUMENTS/POLICY CONCERNS**

Credits generally are provided as a percentage of amounts paid or incurred. Despite the amended language, this bill would essentially allow a 100% credit, which is unprecedented.

This bill would not benefit self-employed taxpayers who are also called to active duty. A taxpayer who is self-employed will not be able to take a credit on the benefits paid as defined in the bill. Thus, this bill would provide differing treatment based solely on entity classification.

This credit would not be limited to benefits paid to employees who are employed in California. As a result, the bill would allow a 100% credit to benefits paid by an employer to an employee anywhere. The author may wish to limit the credit to benefits paid to employees employed in California.

## **LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1862  
As Amended May 6, 2002

AMENDMENT 1

On page 10, line 25, after "to" strikeout "active"

Amendment 2

On page 10, line 34, strikeout: ", including homeland defense." and insert:  
or for homeland defense.

Amendment 3

On page 11, line 30, strikeout: ", including homeland defense." and insert:  
or for homeland defense.